March 22, 2004

The Honorable Edward M. Gramlich
The Honorable Ben S. Bernanke
The Honorable Susan S. Bies
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Re: 'Clear and Conspicuous' Proposals

Dear Governors:

Thank you very much for sharing so generously of your time to allow us to express our views on the recent proposals issued by the Federal Reserve Board (the "Board") regarding "clear and conspicuous" disclosures. As you know, our objection to the proposals is not based on any reluctance on our part to ensure that consumers understand our products. On the contrary, we try to ensure that everyone with whom we do business understands and appreciates the terms and conditions of the transactions in which they are entering.

Our concern is that the Board has provided no demonstration of need for these changes, despite subjecting the financial services industry to enormous compliance costs. The cost/benefit analysis overwhelmingly argues that the proposals be withdrawn.

The proposed changes are not necessary

To understand why the changes are not necessary, it is important to recognize several things about the existing requirements. The five affected regulations already mandate that disclosures must be clear and conspicuous (or readily understandable).' The language, as interpreted, varies very slightly,[2] but the law's intent is fairly clear, both from the plain language, the commentaries, and the case law. Where Congress has

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[1] Regulation B: "clear and conspicuous manner; Regulation E: "clear and readily understandable" 12 CFR 205.4; Rcgulation M: "clearly and conspicuously" 12 CFR 213.3(a); Regulation Z: "clearly and conspicuously" 12 CFR 226.5(a) and 17(a)"; 12 CFR 202.4(d); Regulation DD: "clearly and conspicuously" 12 CFR 230.3(a).

[2] For example, the Rcgulation Z Commentary states about the open-end disclosures: "The 'clear and conspicuous' standard requires that disclosures be in a reasonably understandable form. Except where otherwise provided, the standard does not require that disclosures be segregated from other material or located in any particular place on the disclosure statement, or that numerical amounts or percentages bc in any particular type size." Comment 226.5(a)(2)-1. The Regulation M Commentary states the following: "The clear-and-conspicuous standard requires that disclosures be reasonably understandable. For example, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other; appendix **A** of this part contains model forms that meet this standard. In addition, although no minimum typcsize is required, the disclosures must be legible, whether typewritten, handwritten, or printed by computer." Comment 213.3(a)-2.

determined that consumers need to focus on a few, most important pieces of information, it has "raised the bar" of conspicuousness for those items. Examples include the requirements in Regulation Z that the Finance Charge and APR be "more conspicuous,"[3] the requirement that the more important closed-end disclosures be segregated from other required disclosures[4] and the so-called Schumer Box, where certain disclosures must be in a prominent location and in tabular format.[5] Regulation M also has a segregated disclosure requirement for what are considered to be several of the more important disclosure requirements.[6]

In short, existing standards appear more than adequate to protect consumers by mandating a general principle of clarity that is applicable to the thousands of disclosures in numerous documents and notices, and setting forth special requirements to highlight certain more important items of information. Regulatory agency examinations ensure compliance at many financial institutions. Also, private enforcement operates as a check on violations, including violations of the general clear and conspicuous requirements. The existing requirements are not that different from one another that they are confusing to the industry, nor are they vague or unclear in application. The adoption of a new standard, even with accompanying examples, would not clarify them nor improve their understandability.

Thus, there appears to be little if any rationale for these sweeping changes to format, location and size requirements of these five regulations. And the Board has offered no other evidence, based on actual consumer complaints or examiner findings, to justify them.

The burden of these changes will be enormous

At the same time, the cost of these new requirements will undoubtedly be large. Exactly how large is hard to say,[7] but to get a sense of the scale involved, it is only necessary to consider the following points:

1. The five regulations collectively affect scores of documents at small institutions on paper, web pages, financial kiosks, terminal screens, and other electronic media, and hundreds of documents at larger institutions. The number of documents affected depends on the products and services offered by the institution, and on the coverage of the new requirements.

2. Each document has one or more, in some cases dozens of disclosures mandated by these regulations. Many of them are disclosures integrated with or sharing

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[3] 12 CFR 226.5(a)(2) and 17(a)(2)
[4] Id at 17(a)(1)
[5] Id at 5a(a)(2)
[6] 12 CFR 213.3(a)(2).
[7] According to its comment letter to the Board, Citicorp conservatively estimates that the changes being proposed would cost it at least $185 million per year in increased paper, printing, mailing and related costs for its credit card business alone.

space with contract terms. Many of them share space with disclosures required by other federal regulations or by state laws.

3. The Board must intend the proposals to result in changes to the required disclosures or it would not be proposing them. Lawyers will assume so. Compliance officers will assume so. Courts will assume so. Nevertheless, how the proposals are intended to affect existing disclosures is not at all clear from the language of the proposals themselves. The language introduces a whole new subjective vocabulary (e.g. "designed to call attention to…"), and the terms used in the examples do nothing to clarify it or provide any certainty on how to comply (for example, many call for steps to be taken "whenever possible").

4. Since the Board must be intending that these proposals will change the way disclosures are currently drafted and presented, *every* financial institution will need to have a legal and compliance review of *every one* of its documents, including those in electronic media such as web pages, financial kiosks, and terminal screens, to determine where those changes are necessary and how to make them. The number of actual changes will depend on many factors, including the institution's tolerance for risk, interpretations provided by the Board, and opinions of courts in subsequent litigation.

5. For everyone, the cost of these audits and reviews will be large and the risks of litigation will be much higher—at least for a period of years while the meaning of the changes is clarified. The resulting annual costs will also be large, because of the expanded size of disclosures (as institutions make their fonts larger and format disclosures with headings, bullets, etc.), greater production and mailing expenses, and many other related factors.

The litigation risk will be enormous

We expect the risk of litigation to increase dramatically because the Board's wholesale reformatting of the disclosure standards of these five regulations will result in the loss of two or three decades of legal precedent. Added to the cost of the litigation itself will be the potential for excessive legal penalties under some of these regulations, if the debtor prevails in court. Because of the large dollar exposure risk of complying with new and uncertain standards, settlement premiums will be high, and costs of defense will be significant even if the financial institution ultimately prevails in any litigation. All of these litigation costs ultimately drive up the cost of products for consumers.

For example, Truth in Lending specifically permits a private right of action for violations, and courts have allowed class actions as well.[8] Monetary recovery can include actual damages, statutory damages in many cases, costs and attorney fees. This results in occasional suits over legitimate grievances, but statutory damages can also become an inducement to sue. Rohner and Miller estimate that the early years of the

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[8] The Privacy Act, which is the source of the proposed "clear and conspicuous" standard, contains no private right of action.

statute saw about 2,000 TILA cases filed in federal court every year.' Many more cases were filed in state courts. Even after the Truth in Lending Simplification Act of 1980, which simplified the disclosures and reduced the number of violations for which statutory damages could be obtained, cases numbered in the hundreds every year. As the authors put it, "[e]ven though occasions for TIL violations have been reduced, violations still carry the sanctions of actual and statutory damages, plus costs and attorneys fees. For consumers who are in default or otherwise under financial strain, assertions of TIL violations – obvious or colorable – may still offer tactical advantage or leverage. This use of TIL sanctions becomes even more attractive in a recession economy."" We believe that adoption of the proposed new standard for disclosures will offer many more opportunities for such legal tactics, as the certainty of the previous decisions is lost in the proposed reforms.

Examples of how little basis is needed for litigation under the regulations that are proposed to be amended abound: Rodash,[11] Beach,[12] Riviere,[13] and Pfennig[14] are names that resonate with bank compliance officers, bank counsel and the Board's staff, but are merely representative of the types of litigation the industry routinely faces under *only one* of the five regulations at issue.

Request that the Board withdraw the proposal

Nevertheless, the Board has cited no history of consumer complaints about the clarity of the disclosures mandated by the five regulations.

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[9] Rohner, Ralph, and Fred Miller, Truth in Lending, Ch. 12 updated by Robert A. Cook and David S. Darland (American Bar Association Section on Business Law, Chicago, 2000), p. 785.
[10] Id., p. 789.
[11] Rodash v. AIB Mortgage Co. 16 F.3d 1142 (11th Cir. 1994). The court held that a $22 Federal Express charge for carrying a payoff of a pre-existing mortgage and a $204 Florida intangibles tax assessed and collected at the time of a loan and passed through to the borrower at settlement were both "finance charges" under Truth in Lending Act, and needed to be disclosed as such in making home equity loan. Failure to do so entitled borrower to rescind mortgage for up to three years. Congress subsequently amended TILA to limit the impact of the ruling.
[12] Beach v. Ocwen Federal Bank, 523 U.S. 410, 140 L. Ed. 2d 566, 118 S. Ct. 1408 (1998). The Florida Supreme Court had held that assertion of Truth in Lending Act violations were barred after the three-year statute of limitations set forth in the Act. Because, in a series of opinions, some other courts had held that the same issues could be raised as a defense to a foreclosure action even after the three years, the Supreme Court in Beach granted certiorari to resolve the conflict and upheld the Florida court decision.
[13] Riviere v. Banner Chevrolet, 158 F.3d 335 (5th Cir. 1998), *rehearing granted and opinion* ***withdrawn,*** 166 F.3d 727 (5th Cir. 1999). In an opinion that was subsequently withdrawn, the Fifth Circuit held that an auto dealer who assigned buyers' loan to GMAC was not a "creditor," but a mere "credit arranger" and, consequently, was not subject to suit for disclosure violations.
[14] Household Credit Services v. Pfennig (S. Ct. No. 02-857) For 30 years, Regulation Z has maintained that "overlimit fees" on credit card accounts were "other charges" and had to be disclosed as such; they were not "finance charges" and did not figure in the calculation of an APR. On April 11, 2002, a panel of the Sixth Circuit held that overlimit fees, under the right circumstances, are charges incident to the extension of credit and, therefore, are finance charges within the plain meaning of the Truth in Lending Act, the Federal Rescrvc's long-standing regulation to the contrary notwithstanding. The Supreme Court granted certiorari and has not yet ruled.

The Board has provided <u>no information from any supervisory agency</u> that examination has uncovered a problem in need of correction.

The Board has referenced <u>no studies or research, no focus groups or surveys</u>, to support the need for a different standard on "clear and conspicuous."

As noted above, the costs of this change would be huge. But even aside from the costs, we still urge the Board to withdraw the proposals because they are not needed, because they are vague, and because they will not result in improved clarity, comprehension, or understanding of the information being disclosed. Respectfully, we believe it is bad regulation to propose these changes without a better assessment of whether there are problems that need to be corrected, and if so, how best to correct them and without more appropriately considering the costs associated with any expected benefit from proposed changes.

Thank you once again for the opportunity to meet and to share our views. If you have any further questions, please do not hesitate to get in touch.

Very truly yours,

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